In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 74-1519

ST. PETERSBURG BANK & TRUST COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The sole question presented by the petition is whether petitioner's deduction of certain entertainment expenses was barred by Section 274 of the Internal Revenue Code of 1954. The district court upheld the disallowance of petitioner's claimed expenses (Pet. App. B-1 to B-8) and the court of appeals affirmed *per curiam* (Pet. App. A-1).

Petitioner was organized in 1955 by Hubert Rutland and others. During 1965 and 1966, the years at issue, Rutland was petitioner's controlling shareholder, president and chairman of the board of directors (Pet. App. B-2).

The entertainment expenses incurred by petitioner were as follows. In 1965, petitioner paid for a wedding reception at the Rutland home, a reception honoring the Florida Commissioner of Education held at the Rutland home, two dove shoots held at the Rutland ranch and, finally, a dove shoot and barbecue at the Rutland ranch. In 1966, petitioner paid for a coronation ball at the St. Petersburg Coliseum, a wedding reception at the Rutland home, and three dove shoots and one dove shoot and barbecue at the Rutland ranch. Attendance at these functions was by invitation only, and the written invitations were issued in the names of Mr. and Mrs. Rutland. There was no indication that petitioner sponsored any of the affairs (Pet. App. B-2 to B-3).

The guests invited to these gatherings included petitioner's customers or potential customers, business leaders, public officials, persons of substantial wealth, and certain of petitioner's officers and key employees. Most of petitioner's employees understood that they were invited only because of their positions and many were instructed to circulate among the other guests, pass out their business cards, generally promote the petitioner's services and nurture a personal rapport with established or potential customers. On several occasions, these employees discussed specific transactions which were then pending or contemplated with these established or potential customers (Pet. App. B-2).

In 1962, Congress enacted Section 274 of the Internal Revenue Code of 1954 (Revenue Act of 1962, 76 Stat. 960, 974), in an effort to end some of the abuses surrounding the deduction of entertainment costs as business expenses. This provision was designed to limit such deductions to instances in which the entertainment was clearly moti-

vated by business reasons, gave rise to no undue personal benefit, and might reasonably be expected to engender business benefit. See, H.R. Rep. No. 1447, 87th Cong., 2d Sess., pp. 19-26 (1962); S. Rep. No. 1881, 87th Cong., 2d Sess., pp. 24-38 (1962).

Section 274(a) provides that entertainment expenses are deductible only if they are either "directly related" to the "active conduct" of the taxpayer's business, or are "associated with" the "active conduct" of the taxpayer's trade or business and directly precede or follow "substantial and bona fide business discussion[s]." Congress intended these tests to be alternative (see S. Rep. No. 1881, *supra*, at 26.

Thus, the "directly related" test requires an expectation of direct business benefit. It was aimed at those activities which embody the simultaneous active conduct of business and entertainment and generally permits the deduction of such expenses. On the other hand, the "associated with" test was designed to deal with the situation where the anticipated business benefit was less direct, as in the case of entertainment designed to foster goodwill, rather than an immediately direct benefit. It was designed to cover the situation when business and entertainment are not pursued simultaneously. However, under such circumstances Section 274(a) explicitly limits the deduction to items of entertainment which either precede or follow a substantial and bona fide business discussion.

The courts below correctly concluded that Section 274 bars petitioner's claimed entertainment expenses. These expenses were incurred in an atmosphere far removed from a business setting and petitioner was never even identified as the sponsor of the various social events.

Thus, petitioner's expenses cannot qualify as "directly related" to its business. Moreover, petitioner's expenses cannot meet the "associated with" test of Section 274 because "substantial and bona fide business discussion[s]" never preceded or followed the social events in question. At most, those of petitioner's employees who were in attendance at these events simply distributed their business cards and generally attempted to promote petitioner's business.

Contrary to petitioner's contention (Pet. 7), the decision below does not bar the deduction of bona fide business entertainment expenses. This case, which petitioner concedes is one of first impression (Pet. 5), simply holds that the particular conditions under which the social events were conducted establishes that they are not deductible under Section 274.

It is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

JULY 1975.